Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Rod Pacheco | Analyst: Kristina E. North | Bill Number: AB 2200

Related Bills: See previous analyses | Telephone: 845-6978 | Amended Date: April 13, 2000

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Medical Expenses Deduction/Taxpayers 65 Years or Older

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO _________________________.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ___________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would allow a deduction in computing adjusted gross income (AGI) equal to the cost paid or incurred for medical expenses over $1,000 by a person aged 65 years or older.

SUMMARY OF AMENDMENT

The April 13, 2000, amendment deleted a nonsubstantive, technical change to the definition of "corporation" in the Revenue and Taxation Code (R&TC) and added the provision discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifies it would apply to taxable years beginning on or after January 1, 2001.

SPECIFIC FINDINGS

Current state and federal laws allow taxpayers a variety of deductions when calculating their tax liability. For individual taxpayers, some deductions are specifically allowed as a deduction from gross income in computing AGI. To determine taxable income, individual taxpayers reduce AGI by deducting either the applicable standard deduction or their itemized deductions.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Gerald H. Goldberg	5/25/00
____ N	____ OUA	__X__ PENDING		

Current federal law, to which **state law** conforms, specifically allows a deduction for unreimbursed medical care expenses as an itemized deduction, but only to the extent that the expenses exceed 7.5% of the taxpayer's AGI. "Medical care expenses" are amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease or for the purpose of affecting any structure or function of the body; transportation cost of a trip primarily for and essential to medical care; and qualified long-term care services or for medical insurance (including premiums paid under the Social Security Act). Lodging while away from home for a trip primarily for and essential to medical care, capital expenditures for home improvements and additions added primarily for medical care (to the extent that the cost of improvement exceeds any increase in the value of the property), insulin, prescription drugs and medicines also may qualify as medical care expenses.

This bill would allow an unlimited deduction in computing AGI for 100% of the costs exceeding $1,000 paid or incurred for medical expenses by a qualified taxpayer.

This bill would define:

- "medical expenses" as those expenses allowed as deductions under the federal law.

- "qualified taxpayer" as a taxpayer who is aged 65 years or older.

This bill would reduce the amount of the deduction by the amount that the AGI of the taxpayer exceeds $50,000 for an individual and $100,000 for married persons filing jointly.

This bill would specify that this deduction would be in lieu of any other deduction or credit allowed for the same expenses claimed for this deduction.

Policy Consideration

This bill would create a federal/state difference in computing adjusted gross income by allowing a state "above the line" deduction for medical expenses, while federal law would continue to treat costs for medical care as a "below the line" deduction.

Implementation Considerations

Department staff has identified the following concerns:

- This bill provides a deduction in calculating AGI; however, this bill also reduces the amount of the deduction based on the amount the AGI exceeds a limited amount ($50,000 for single, $100,000 for married filing jointly). It is unclear whether the author intended the AGI limitation to be calculated with or without the deduction. Clarification is needed.

- It is unclear when the taxpayer must reach the age of 65 (i.e., by the end of the tax year or when the return is filed). Specifying that the taxpayer must be 65 at the end of the tax year would be consistent with other tax benefits allowed to senior citizens.

Department staff is available to assist the author with these or other issues pertaining to this bill.

FISCAL IMPACT

Departmental Costs

With the implementation considerations resolved, this bill should not significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in revenue losses on the order of $25 million annually.

Estimated Revenue Impact of AB 2200 As Amended 4/13/00 [$ In Millions]			
2000/2001	2001/2002	2002/2003	2003/2004
minor loss	-$30	-$25	-$25

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Tax Revenue Discussion

Deductible medical expenses in excess of the proposed $1,000 threshold and marginal tax rates of qualified taxpayers would drive the revenue impact of this bill. The revenue loss impact is primarily due to the relative differential between deduction thresholds – the proposed $1,000 relative to the present law 7.5% of AGI. To a lesser degree, the revenue loss also results from the additional taxpayers, not currently itemizing medical expenses, who could take this deduction.

For qualified taxpayers reporting medical expenses on Form 540, Schedule A, the proposed deduction for AGI was simulated in place of any present law deduction. In addition, health care spending values were imputed to qualified taxpayers who did not report any medical expenses on their tax returns because of the current 7.5% threshold. Estimates above assume that AGI is calculated first without the proposed deduction for purposes of the AGI limitation of $50,000 for an individual and $100,000 for married persons filing joint returns. For purposes of phasing-out the proposed deduction, it is assumed that the otherwise allowable expense is reduced a dollar for each dollar in excess of the AGI limit.

Based on national household spending data for 1997, average annual out-of-pocket expenditures for health care expenses by seniors were projected at $3,805 in 2001. Total health care spending of $4,900 million was calculated by multiplying the number of senior taxpayers by the projected average out-of-pocket expenditure. (Taxpayer here means the total number of senior individuals represented by a tax return. That is, in the case of a joint return in which both individuals are age 65 or older, two senior taxpayers would be counted.) Health care expenses reported on Schedule A by senior taxpayers were deducted from the total [$4,900 million - $3,500 million = $1,400].

From the estimated balance of $1,400 million of health care expenditures, an average expenditure of $950 was derived for senior taxpayers who did not report health care expenses on their tax return. It was assumed that half of the senior taxpayers not reporting health care expenses on Schedule A would have health care expenditures equal to 50% of the average, while the other half would have healthcare expenditures equal to 150% of the average. These imputed expenses were then used to calculate the proposed deduction (to the extent total health care expenses exceeded $1,000) relative to each tax return.

BOARD POSITION

Pending.